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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

*The US-East Asian Textile Agreements:
Some International Economic Implications*

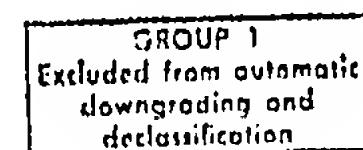
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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1971

INTELLIGENCE MEMORANDUM

**THE US-EAST ASIAN TEXTILE AGREEMENTS:
SOME INTERNATIONAL ECONOMIC IMPLICATIONS**

Introduction

1. In mid-October the four East Asian textile producers reached agreements with the United States limiting their shipments of man-made fiber and woolen textiles to the US market. The agreements came in the wake of strong US pressures. Textile industry leaders in Hong Kong, Taiwan, South Korea, and Japan have all claimed the export control measures will seriously damage their industries and result in major losses in export earnings. This memorandum briefly describes the agreements and assesses the likely impact on the four East Asian producers as well as some implications for world textile trade.

Discussion

The New Export Controls

2. Japan's 15 October agreement with the United States⁽¹⁾ places much stiffer controls on textile shipments to the US market than did Tokyo's earlier unilateral "voluntary" controls. The new restraint program

1. The textile agreements with the East Asian countries are memoranda of understanding pending conclusion of working out final details. For the text of the US-Japanese Memorandum of Understanding and Japanese export statistics on controlled items, see the Appendix.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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covers shipments of man-made fiber and woolen yarns as well as the previously controlled shipments of fabrics and finished goods of these materials.⁽²⁾ For the year beginning October 1971, shipments of man-made fiber textiles will be limited to a 5% growth over the level reached in Japan's fiscal year April 1970 - March 1971. During this fiscal year, man-made textiles accounted for about 70% of the volume and 60% of the value of total textile exports to the US market. Shipments of woolens, which make up about 4% of the volume of exports covered by the agreement, will be allowed to grow by only 1%. These same growth rates will be permitted for the remaining two years of the three-year agreement.

3. Limitations on shifting quotas among product and fiber categories is the new agreement's most important element. The 5% overall annual growth limit called for in the earlier voluntary program could be adhered to by allowing fast-growing sales of synthetics to offset declining cotton sales. Exclusion of cotton in the new agreement prevents this practice. In addition, the new agreement places item-by-item limits on shipments of 18 products, including some of Japan's fastest growing textile exports to the United States. Moreover, there is little scope for shifting unused quotas from one item to another. Beyond this, the rapid expansion of any specific product not covered in the item-by-item restrictions can be curtailed. In the event exports of any product grown by 10% a year in the case of man-mades and 3% in the case of woolens, the United States can call for consultations, and while talks are under way no further increase in shipments would be allowed.

4. Export controls agreed to by other East Asian textile producers are somewhat less severe than those accepted by Japan.⁽³⁾ Although some details remain to be worked out, their agreements essentially limit the overall growth in shipments of man-made fiber to the United States to an average of about 7.5% annually and 1% for woolens. The base year is the same as Japan's, but the life of the agreement is for five years rather than three. The agreements include item-by-item restrictions as well as a trigger device which can be used to limit the growth in shipments of almost any product covered by the program. In contrast to the Japanese agreement, however, there will be some shifting allowed between cottons and other fiber

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categories. All four East Asian countries' cotton textile shipments to the United States are limited under the 1962 Long-Term Agreement.

How Japan Fares

5. Japanese textile exports will no doubt be hurt by restraints, but the adverse effects will not be especially severe. The agreement comes at a time when the growth of Japan's export sales to the US market are already slowing as a result of increasing competition from other East Asian textile suppliers and because the once rapidly growing US market for synthetics is now just about peaking. Under these circumstances, some further slowdown in sales growth was to be expected in the coming years regardless of export restraints. Where the new agreement will have its main impact is in preventing any dramatic increase in exports of new product lines or lines not yet fully developed by the Japanese.

6. The new agreement still leaves room for expanding the Japanese share of the US market. The 5% growth rate permitted for man-made fiber products is substantially faster than recent growth in US consumption of these items. In the case of woolens, US consumption is actually declining. The impact of restraints also will be eased somewhat as a result of Japanese efforts since late 1970 to flood the US market before any restraint program went into effect. This served to boost shipments during the base year, on which future export volumes are determined, to an abnormally high level. Thus, in the case of man-made fiber textiles, shipments during the base year ending March 1971 amounted to some 900 million square yards, compared with about 775 million square yards during the year ending December 1970. Over the three-year life of the agreement, this difference will add more than 400 million square yards to the level of permissible exports and yield an 8% annual growth rate over the 1970 calendar year level.

7. On the basis of volume increases allowed under the restraints and in view of the continued downward trend in cotton textile exports, we estimate that overall sales value will increase by at least 2% annually over the next several years. Any higher rate will be largely determined by Japan's ability to upgrade existing product lines, since item-by-item restraints limit the possibility of moving into new products. This situation would have developed even without restraints because of intensifying competition from producers in less developed countries, which pay much lower wages than the Japanese textile industry. The upgrading process essentially means moving into the more fashion-oriented clothing and fabric market and out of staple products. The import market for fashion clothes is dominated by European suppliers, but the Japanese can be expected to be aggressive competitors in this field where pricing is less important than the cut of

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material and the ability to respond quickly to rapidly changing styles. Most European clothing exports to the United States, for example, are handled by air freight. Given their efficient international marketing apparatus, the Japanese should have little trouble adjusting their handling methods to meet the requirements of a fast-changing market.

8. US agreements with the three other East Asian countries will have a two-edged impact on Japanese textile sales. On the one hand, Japan will be helped by the restraints since, given a free hand in the US market, these low-cost suppliers would almost certainly cut deeply into product lines now dominated by Japan as has already occurred with many items. With competition now restrained, Japan will be better able to maintain its position in the US market. On the other hand however, Japanese synthetic fiber and fabric producers will be hurt by restraint programs of the other East Asian countries since Japan supplies them with most of their imports of intermediate textile products which in turn are processed into finished goods for sale in the US market. Even so, there will still be considerable room for expanding Japan's sales to the region since in the past the value of Japanese exports to other East Asian producers has grown faster than the volume of their shipments to the US market.

9. Even if the growth of overseas sales does slow appreciably, the Japanese textile industry is in a good position to cope with the situation. Japan's domestic market for textiles is one of the largest and fastest growing among developed countries, and in value terms it takes more than three-fourths of the industry's output. During the late 1960s the volume of domestic textile consumption grew by almost 6% annually, nearly twice as fast as in the United States, and the government expects domestic demand to accelerate during the first half of the 1970s. Meanwhile, Japanese producers are protected by Tokyo's tight import restrictions, and past experience suggests these will be further strengthened should imports become a serious threat. Imports now account for approximately 4% of the domestic market, compared with 12% for the United States in 1970.

10. In addition to the protection it provides in the domestic market, Tokyo has offered the industry large amounts of financial aid - up to \$300 million - in return for going along with the textile agreement. Essentially, this would serve as a subsidy for the many small-scale textile producers who were facing increasingly serious problems even before export restraints were adopted. Earlier this year, for example, Tokyo made some \$250 million available to the industry, including \$170 million for long-term low-interest loans from government-affiliated banks financing small businesses. These programs will substantially ease any adjustment problems arising from export controls by accelerating the modernization of textile plants and equipment. Over the longer term, however, numerous small textile firms

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can be expected to close down - mainly because of the continued erosion of Japan's competitive international position rather than the impact of export restraints.

How the Others Fare

11. The other East Asian producers will have a somewhat harder time adjusting to export restraints than Japan, but predictions of disaster for their textile industries are unfounded. Over the life of the restraint program, overall shipments of man-made fiber textiles to the United States will still be able to increase by as much as 10% annually over the 1970 level, and the value of exports will undoubtedly increase considerably faster. Taiwan, South Korea, and to a lesser extent Hong Kong basically sell very low-value items to the US market, and consequently they can achieve quick and substantial gains through quality improvements even without changing their product mix. The value of Taiwan's total textile exports to the United States last year, for example, increased almost twice as fast as the volume without any significant change in the product mix. Given the allowable volume increases and the possibility of quality upgrading, a 10%-15% annual increase in sales value to the United States during the coming years seems reasonable to expect.

12. Although a 10% annual increase in sales value would represent a substantial slowdown from previous growth rates, it would probably not seriously hurt the textile industries in Hong Kong and Taiwan. Hong Kong's dependence on the US market has declined steadily in recent years and last year accounted for only about one-fourth of the increase in overall textile sales, compared with almost two-thirds in 1968. Most of the growth in sales is now going to countries such as Australia, Canada, Japan, and West Germany, and, as long as there is no clamp-down in these markets, overall export growth should remain near last year's 13%. In the case of Taiwan, some decline in overall export growth is likely to occur since the US market accounted for about 38% of the increase in total sales last year. But even with export restraints, sales to the US market will reach between \$250 million and \$300 million by 1975, and, if sales to other countries grow at only half the rate of recent years, total textile sales should reach on the order of \$800 million by the mid-1970s. This is almost double last year's level, and, consequently, even with added trade restrictions, the industry will still have plenty of room to expand in the coming years.

13. South Korea will be hardest hit by export restraints since it is most dependent on the US market. In 1970 the United States took about 40% of total textile exports and almost half the increase in sales. How deeply the South Korean textile industry will be hurt by export controls, however, will also depend on what happens in its other major markets,

SECRET

especially Japan. More than one-third of the increase in total textile sales since 1965 has gone to Japan, and if that market continues to grow at near the pace of recent years the South Korean textile industry would probably have no major problem overcoming the adverse impact of export restraints. In any case, some slowdown from the extraordinarily rapid growth of sales to the US market in recent years could have been expected even without restraints. Indeed, the growth rate in shipments of man-made fiber products has declined from 132% in 1967 to under 20% in 1970.

14. In sum, the three smaller East Asian producers are likely to manage reasonably well despite export controls. Sales value will probably grow substantially faster than volume as product quality improves, and in all three cases export earnings from textiles will increase considerably over the life of the agreements. Even with some decline in the growth of textile sales, however, overall economic activity in the region will be little affected. New growth industries are rapidly emerging and in time will replace textiles in importance. Indeed, exports of such items as electronic equipment, plastics, and light machinery have been increasing much faster than textiles, and most go to the US market. Hong Kong, Taiwan, and South Korea all have very dynamic economies, and continued economic growth over the long term depends more on the development of new export industries and products than on the continuing growth of their textile industries.

Worldwide Implications

15. The latest round of textile agreements with East Asian producers will no doubt bring about some changes in world textile trade. While East Asian producers long had virtually unfettered access to the US market for man-made and woolen textile products, most other major importing countries have built up an extensive control system aimed at minimizing textile imports. In all likelihood these controls will now be challenged as the East Asians seek alternative outlets for their goods. At the same time, however, the new restraint programs are likely to stimulate the development of export-oriented textile industries in countries such as Brazil, the Philippines, and Singapore, which are not covered by export controls, with output aimed chiefly at the US market. Indeed, this process is likely to be aided by Japanese firms which can be expected to set up operations in such countries with an eye toward circumventing export controls.

16. Over the long term, the development of an orderly world market for textiles will require a broad international agreement. The East Asian textile producers would no doubt be among the strongest supporters of such an agreement since their share of the very large US market is already essentially frozen and could be hurt by any newcomers not restrained by export controls. At the same time, they would probably view an

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international agreement as an opportunity to get some easing of import restrictions now imposed by European Community countries. Indeed, the East Asians face the possibility of even tighter controls on the part of the European Community, which fears a flood of cheap imports from the region in the wake of the new limits on access to the US market. An international arrangement could serve to forestall such a move. For its part, the European Community probably would like an international agreement to replace its patchwork of bilateral agreements. The Community could then blame import controls on the international agreement.

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Appendix

Memorandum of Understanding

1. Japan will apply restraints to wool and man-made fiber textile exports to the United States for three years beginning Oct. 1, 1971.

2. The base level shall be 950 million square yards equivalent for all wool and man-made fiber textile products divided between wool and man-mades as in United States imports during the twelve-month period ending March 31, 1971. The annual growth rates to be applied to this base level for purposes of establishing the first and succeeding arrangement year levels for both Annex A and other categories shall be 5 per cent per annum over-all, provided that all wool textile categories shall be increased by one per cent per annum.

3. Within the over-all limits for wool and man-mades as adjusted pursuant to the provisions of this arrangement, annual specific limits shall be established for the groups, subgroups and categories shown in Annex A. Within the adjusted over-all limits, these group and subgroup limits may be exceeded by the percentage shown in Annex A for each group or subgroup, plus the carryover provided for under Paragraph 5. Individual Annex A category limits may be exceeded in accordance with Note (i) of the Annex and Paragraph 5.

The Annex A limits shall be based on United States imports in these categories from Japan during the twelve-month period ending March 31, 1971.

4. (a) If the United States determines that imports from Japan in any category not subject to a limit set out in Annex A, or imports of any particular products within a category which is set out in Annex A, are increasing so as to contribute to disruption or the threat thereof in the United States market, it

will request consultations with Japan. Such consultations will be held and concluded promptly. Pending a mutually satisfactory solution between the two countries, Japan shall limit exports in the category or product in question for that arrangement year, to 105 per cent of the level of imports in such category or product, 103 per cent for wool categories or products, during the most recent twelve-month period preceding the request for consultations for which relevant data are available to the two governments. The United States will make similar consultation requests to the Republic of Korea, the Republic of China and Hong Kong in cases where imports in the same category or product are increasing.

(b) It is understood that with respect to categories not set forth in Annex A consultations referred to in (a) above will also be requested whenever imports in a twelve-month period increase to a level of that for the twelve months ending March 31, 1971 compounded by 10 per cent for man-made fiber textile categories and 3 per cent for wool textile categories, and are not less than 500,000 square yards each for man-made fiber categories other than apparel, 350,000 square yards equivalent each for apparel categories, and 100,000 square yards equivalent each for any wool textile category. Provided, however, that in the event consultations are requested at the levels indicated in this subparagraph, and pending a mutually satisfactory solution, Japan shall limit its exports for the category in question in the arrangement year in question to the level of imports which formed the basis for the consultation request.

(c) Any consultation requested by the United States under this provision shall be accompanied by a detailed factual

statement of reasons and justifications for the request, including relevant data on imports from third countries.

5. Beginning with the second year, carryover shall be provided in an amount equal to the lesser of the actual shortfall in the preceding year or 5 per cent of the preceding year's limit before adjustment for the flexibility provided in the Annex, Paragraph 8 or this paragraph. In determining shortfalls, there must be a shortfall of the overall limits for Annex A and non-Annex A categories taken as a whole, and, for any categories in Annex A, there must be a shortfall in the group before adjustment for flexibility, and a shortfall in the particular category before adjustment for Note

(i) of the Annex. For non-Annex A categories as a whole, there must be a shortfall of the over-all limit. All carryover amounts in non-Annex A categories shall be included in applying the provisions of Paragraph 4.

6. If Japan considers that as a result of the restraints by this arrangement, Japan is placed in an inequitable position vis-a-vis a third country whose exports to the United States are subject to restraint or if Japan is, or is threatened to be, put in a substantially disadvantageous position compared with any other country because of such factors as a remarkable increase of exports by such an exporting country to the United States, Japan may request consultations with the United States with a view to taking appropriate remedial action such as a reasonable modification of the arrangement. Such consultations will be held and concluded promptly. Upon their conclusion, the U.S. will take such appropriate remedial measures as may be satisfactory to the two governments.

Reprinted from *Japan Times*, 16 October 1971.

7. (a) During this arrangement, experts of the Ministry of International Trade and Industry and of the Department of Commerce will meet monthly to exchange current data on exports and imports of these products between Japan and the United States, to review in detail the implementation of the arrangement, and to consider any problems arising thereunder including flexibility problems and including classification problems with Japan in a reasonable manner consistent with the principles set forth in the preamble.

(b) During the first two years of this arrangement, these experts shall meet to consider a number of export approved contracts existing prior to Oct. 1, and concerning categories listed in Annex A which, if fulfilled, would cause exports to exceed levels provided for in the first year of this arrangement. The experts, taking into account conditions in the U.S. market, shall determine whether such amounts may be exported and, in the event such exports are permitted, the resulting excess of the first year levels shall be deducted from exports permitted during the second year of this arrangement. The experts shall also consider hardship situations in either Japan or the United States which may be related to the operation of this arrangement or the trade conducted thereunder and may make appropriate recommendations to their governments for the resolution of such situations.

8. The following special transitional measure is also provided for the first two years of the arrangement.

In addition to the amounts provided for above, exports of yarns in Categories 200-205 may be increased by an amount equal to 10 per cent of the over-all limit referred to in Paragraph 4

less the sum of the Annex A limits, including adjustments by the percentages shown in the Annex, provided that a shortfall of an equivalent square yard amount occurs in the cotton textile agreement during the year in question.

9. The scope of the products to be covered by each of the U.S. TQ* categories, the definitions of the products concerned, and the rates of conversion into square yards equivalent will be determined in accordance with U.S. Customs classifications and definitions, subject to further clarification where necessary. Any textile product which is wholly or in part of wool and/or man-made fiber, but not chief value cotton, shall be subject to the terms of this arrangement. Any questions with regard to the assignment of such products which are not chief value wool or chief value man-made fiber shall be subject to consultations between the two governments, which shall take into account the marketing of such products in the United States. For the purposes of this arrangement, the term "man-made fiber" refers to any fiber other than natural fiber. Experts of the two governments shall meet as soon as practicable to discuss the application of the above definition to certain articles which the Japanese Government considers to be products of other industries than the textile and apparel industries, and not textile or apparel products.

10. Japan will endeavor to space exports as evenly as practicable on a quarterly basis throughout each arrangement year, taking seasonal factors into account.

11. A separate numbered paragraph containing the following language shall be included in the arrangement:

"The two governments recognize that their rights and obligations under the General Agreement on Tariffs and Trade

are not affected by this arrangement."

12. The following paragraph shall be inserted as the preamble to this arrangement:

"The purpose of this arrangement is to prevent an abrupt increase and to provide for orderly development of export trade in wool and man-made fiber textiles from Japan to the United States consistent with the healthy development of the textile economies of both countries.

For this purpose, and in accordance with the provisions of this arrangement, Japan will conduct her exports to the United States of wool and man-made fiber textile products to see to it that an aggregate annual increase in the exports of such products will not be in excess of the levels provided for in the arrangement, and the United States will give consideration in implementing this arrangement to assuring the full utilization of such levels by Japan."

13. During the third year of this arrangement, the two governments shall consider extending the arrangement for a further period of time.

14. Each government may at any time propose modification of this arrangement. The other government shall give sympathetic consideration to such proposal.

15. The above provisions of this understanding, meeting the requirements necessary for the conclusion of an administrative arrangement, will be formalized into a bilateral arrangement between the two governments at the earliest practicable time.

* Textile Quota

Annex A**Group I—7.5 per cent**

TQ 206

Woven fabrics, wholly of continuous man-made fiber yarns, cellulosic.

TQ 210

Other woven man-made fiber fabrics, with sublimit for fabrics containing 17 per cent or more by weight of wool.

TQ 211

Knit fabrics.

Group II—5 per cent

TQ 208

Woven fabrics, wholly of continuous, man-made fiber yarns, noncellulosic.

TQ 209

Woven fabrics, wholly of spun yarns, in chief value noncellulosic man-made fibers.

Group III**Subgroup A—10 per cent**

TQ 216

Dresses, knit.

TQ 222

Trousers, slacks and shorts, knit, women's, girls' and infants'.

TQ 236

Skirts, not knit.

TQ 238

Trousers, not knit.

TQ 219

Subgroup B—2.5 per cent
Shirts, other (including blouses), knit.

TQ 221

Sweaters and cardigans, knit.

TQ 229

Coats, not knit.

TQ 228

Group IV—5 per cent
Blouses, not knit.

TQ 234

Dress shirts, not knit.

TQ 235

Shirts, other, not knit.

TQ 104

Group V—2.5 per cent
Woolens and worsteds, with sublimit for woven wool fabrics over 6 ounces per square yard.

Group VI—5 per cent

TQ 120

Men's and boys' suits.

TQ 124

Slacks and trousers.

i. Exports in any category within a group may not exceed 103 per cent of the group ceiling for that category (as adjusted by the percentage shown) multiplied by the percentage which the category accounted for of the total of U.S. imports from Japan of the categories in that group (subgroup, in Group III), during the twelve-month period ending March 31, 1971.

Japanese Exports of Man-Made and Woolen Textiles a/

Itemized Control and Permitted Growth Rates	Calendar 1970		Percentage Change 1970 over 1969	April 1970 - March 1971		
	Thousand Equivalent Square Yards	Thousand US \$		Volume	Value	Thousand Equivalent Square Yards
Group I - 7.5%						
TQ 206 Woven fabrics, of continuous yarn, cellulosic	36,374	11,168	-13	-10	35,359	10,616
TQ 210 Woven fabrics, including mixed yarn	18,583	16,065	-1	8	18,556	15,292
TQ 211 Knit fabrics	66,400	26,304	201	224	94,067	36,098
Group II - 5%						
TQ 208 Woven fabrics, of continuous yarn, non-cellulosic	117,439	53,606	33	72	125,013	58,390
TQ 209 Woven fabrics, of spun yarns, non-cellulosic	17,121	9,016	-12	16	18,791	9,573
Group III A - 10%						
TQ 216 Knit dresses	5,391	1,671	10	5	5,841	1,863
TQ 222 Knit trousers, slacks and shorts, women's, girls', infants'	12,583	12,281	148	182	14,154	14,519
TQ 236 Woven skirts	2,953	2,281	82	77	3,070	2,389
TQ 238 Woven trousers	10,495	11,496	48	44	10,347	11,296
Group III B - 2.5%						
TQ 219 Knit shirts, other (including blouses)	20,445	11,256	-7	5	22,856	13,654
TQ 221 Knit sweaters and cardigans	37,608	15,162	-43	-38	37,267	14,741
TQ 229 Woven coats	32,698	15,604	b/	11	27,243	14,265
Group IV - 5%						
TQ 228 Woven blouses	10,472	8,352	30	70	9,894	8,092
TQ 234 Woven dress shirts	13,544	7,526	-2	15	12,658	7,391
TQ 235 Woven shirts, other	12,119	6,001	b/	4	10,754	5,561
Group V - 2.5%						
TQ 104 Woolen and worsteds	31,474	45,051	-28	-29	26,869	38,492
Group VI - 5%						
TQ 120 Men's and boys' suits, wool	1,193	4,830	26	29	1,377	5,603
TQ 124 Slacks and trousers, wool	2,658	7,863	6	13	2,500	7,328
Total under item control	449,551	265,533	10	15	476,616	275,163
Other man-made and wool fabrics and finished goods	198,868	93,671	9	2	211,475	93,515
Subtotal	648,419	359,204	10	12	688,091	368,678
Man-made yarns	173,321	23,098	203	135	254,759	33,528
Total man-made and wools	821,740	382,302	27	15	942,850	402,206

a. Based on US import data.

b. Less than 1%.